

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-03
INR-10 NSAE-00 ICA-11 TRSE-00 XMB-02 OPIC-03
SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-07
CEA-01 PA-01 /092 W
-----072307 101835Z /50

R 101733Z APR 78
FM AMEMBASSY MADRID
TO SECSTATE WASHDC 4166
INFO AMEMBASSY BONN
AMEMBASSY BRUSSELS
AMEMBASSY LISBON
AMEMBASSY LONDON
AMEMBASSY OSLO
AMEMBASSY PARIS
AMEMBASSY THE HAGUE
USMISSION USNATO

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BRUSSELS ALSO FOR USEEC
PARIS ALSO FOR USOECD

E.O. 11652:N/A
TAGS: ECON, SP
SUBJ: PRIME MINISTER AND VICE PRESIDENT REAFIRM
ECONOMIC AUSTERITY PROGRAM

REF: MADRID 3058; MADRID 3687
1. IN MAJOR SPEECHES BEFORE PARLIAMENT APRIL 5
PRIME MINISTER SUAREZ AND SECOND VICE PRESIDENT AND
MINISTER OF ECONOMY ABRIL MARTORELL STRONGLY REAFFIRMED
THEIR INTENTION TO STICK WITH THE GOVERNMENT'S TIGHT
MONEY AUSTERITY PROGRAM. THEY CITED CONSIDERABLE SUCCESS
SINCE THE MONCLOA PACTS WERE SIGNED IN OCTOBER 1977 IN
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REDUCING AN INFLATION RATE THAT HAD BEEN APPROACHING 30,
AND SIGNIFICANTLY LOWERING A CURRENT ACCOUNT DEFICIT
THAT HAD THREATENED TO HIT \$5 BILLION BY THE END OF 1977.
THE PRIME MINISTER TREATED THE ECONOMY ONLY BRIEFLY,
STATING THAT THERE WOULD BE NO CHANGE IN GOVERNMENT
POLICY AS EMBODIED IN THE MONCLOAPACTSWHICH WAS DESIGNED
TO STRENGTHEN MARKET FORCES WHILE ALSO PROMOTING GREATER

SOCIAL JUSTICE THROUGH FISCAL AND OTHER REFORMS. SPEAKING AT SOME LENGTH, ABRIL SAID IT WAS STILL TOO EARLY TO THINK OF A MAJOR CAMPAIGN TO STIMULATE THE ECONOMY. TO DO SO WOULD ONLY TOUCH OFF ANOTHER AND MORE DEVASTATING ROUND OF INFLATION. AT THE SAME TIME, THE GOVERNMENT IS COMMITTED TO BASIC STRUCTURAL REFORM IN THE TAX SYSTEM, IN THE FINANCING OF SOCIAL SECURITY AND PUBLIC SECTOR INDUSTRIES, AND IN THE OPERATION OF BANKS AND FINANCIAL MARKETS. SOME IMPROVEMENTS HAVE ALREADY BEEN ACCOMPLISHED; OTHERS WILL BE IN EFFECT SOON. THE GOVERNMENT WILL COMPLETE WORK ON ITS KEY ENERGY PLAN BY THE END OF APRIL. ALL THESE MEASURES WERE PART OF BRINGING MARKET DISCIPLINE TO THE TOO LONG ISOLATED AND OVER PROTECTED SPANISH ECONOMY. THIS WAS THE HEART OF THE GOVERNMENT'S ECONOMIC PLAN. THERE WERE HARSH COSTS INVOLVED SUCH AS HIGHER UNEMPLOYMENT (HE CITED 840,000, OR ABOUT 6 PERCENT OF THE LABOR FORCE, AS CURRENTLY UNEMPLOYED) AND FLAT DOMESTIC DEMAND. BUT THIS HAD BEEN FORESEEN AT THE TIME THE MONCLOA PACTS WERE SIGNED AND ALL THE POLITICAL PARTIES HAD AGREED THAT THESE COSTS WERE NECESSARY.

2. ABRIL SAID THAT THE GOVERNMENT LOOKED FOR THE BEGINNING OF A SLOW BUT STEADY IMPROVEMENT IN THE SECOND HALF OF 1978. GOVERNMENT EXPENDITURES, WHICH WERE BEING HELD LOW DURING THE FIRST 6 MONTHS OF THIS YEAR, WOULD PICK UP IN THE SECOND HALF. LOWER INFLATION RATES DUE TO THE LIMITED OFFICIAL USE

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AUSTERITY PROGRAM WOULD GIVE A BOOST TO CONSUMER DEMAND. IMPLEMENTATION OF STRUCTURAL REFORMS, AND "THE CONSOLIDATION OF ITS POLITICAL PROCESS THAT CARRIES WITH IT THE REDUCTION OF UNCERTAINTIES AND RISKS," WOULD YIELD AN IMPROVED CLIMATE FOR INVESTMENT AND GENERAL CONFIDENCE IN THE FUTURE THAT SHOULD AID IN THE RECOVERY.

3. COMMENT: EMBASSY BELIEVES ABRIL IS BEING OVERLY OPTIMISTIC IN SUGGESTING THAT THE GOVERNMENT'S ECONOMIC POLICIES HAVE BEEN SUFFICIENTLY SUCCESSFUL TO BRING ABOUT THE BEGINNINGS OF A RECOVERY DURING THE SECOND HALF OF THIS YEAR. THE INFLATION RATE HAS INDEED BEEN REDUCED FOR THE MOMENT (1.5PCT IN JANUARY 0.8PCT IN FEBRUARY) BUT IT WILL TAKE CONSIDERABLY MORE THAN A 6 MONTH PAUSE TO WRING SEVERAL YEARS OF INFLATIONARY PSYCHOLOGY OUT OF THE SPANISH ECONOMY. THE ECONOMIC MEASURES EMBODIED IN THE MONCLOA PACTS ARE, IN FACT, PART OF A TWO YEAR PROGRAM; AND NO GOVERNMENT ECONOMIST EXPECTS THE INCREASE IN THE CONSUMER PRICE INDEX TO BE LESS THAN 17PCT FOR 1978 NOR THE REAL INCREASE IN GDP TO BE ABOVE 1 PERCENT. THE GOVERNMENT BELIEVES THAT THE HOPED FOR STEADY AND RELATIVELY TRANQUIL POLITICAL EVOLUTION,

TOGETHER WITH CONTINUING SUCCESS IN REDUCING INFLATION, WHICH INCLUDES HOLDING WAGE INCREASES TO 22, WILL BEGIN TO RESTORE INVESTOR CONFIDENCE. THEY OBVIOUSLY RECOGNIZE THE DANGERS OF HEAVY, AND PREMATURE FISCAL STIMULATION. WHETHER THEY CAN HOLD THE LINE OR NOT AS CRITICISM OVER UNEMPLOYMENT MOUNTS IS THE KEY, SHORT TERM QUESTION.

DEVALUATION AND FLAT DOMESTIC DEMAND HAVE COMBINED TO IMPROVE THE CURRENT ACCOUNT PICTURE IN LATE 1977 AND EARLY 1978. BUT OVER THE LONGER TERM INDUSTRIAL ACTIVITY IN SPAIN REMAINS PARTICULARLY DEPENDENT ON IMPORTS FOR GROWTH, ESPECIALLY IN ENERGY, CAPITAL GOODS AND TECHNOLOGY. GIVEN AN INCOME ELASTICITY OF DEMAND FOR

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R 101733Z APR 78
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IMPORTS OF 1.5 (ACCORDING TO FINANCE MINISTER FERNANDEZ ORDONEZ) ECONOMIC GROWTH, WHEN IT DOES BEGIN AGAIN, WILL CARRY WITH IT A WORSENING OF THE CURRENT ACCOUNT. THE GOVERNMENT'S ECONOMIC POLICY IS AT LEAST IN PART INTENDED TO HELP BROADEN AND DEEPEN THE ECONOMY TO STIMULATE EXPORTS AND MAKE THE COUNTRY LESS DEPENDENT ON IMPORTS FOR ECONOMIC GROWTH. BUT THIS IS A LENGTHY PROCESS AND NO QUICK IMPROVEMENTS CAN BE EXPECTED.

THEREFORE, SPAIN WILL CONTINUE TO RUN CURRENT ACCOUNT
DEFICITS FOR THE FORESEEABLE FUTURE. STABLER

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